DOW THEORY LETTERS INC.

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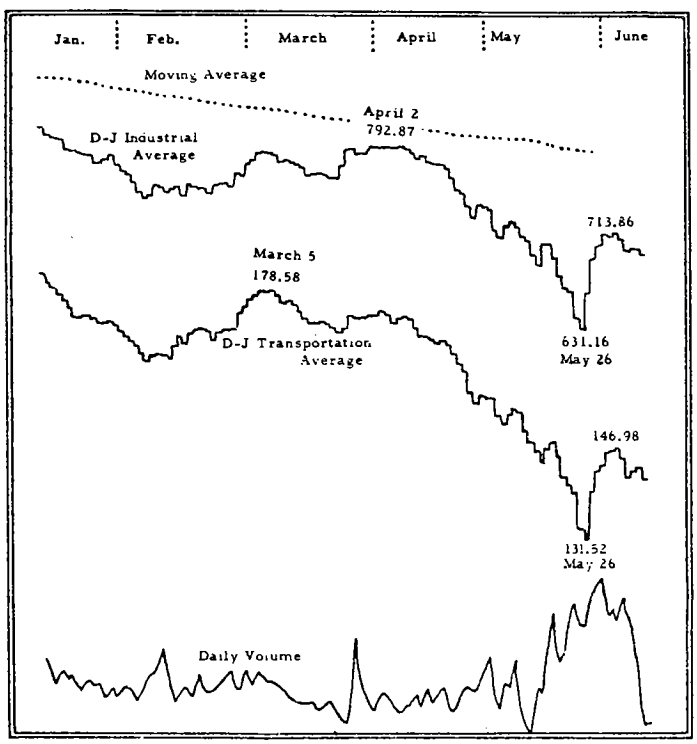
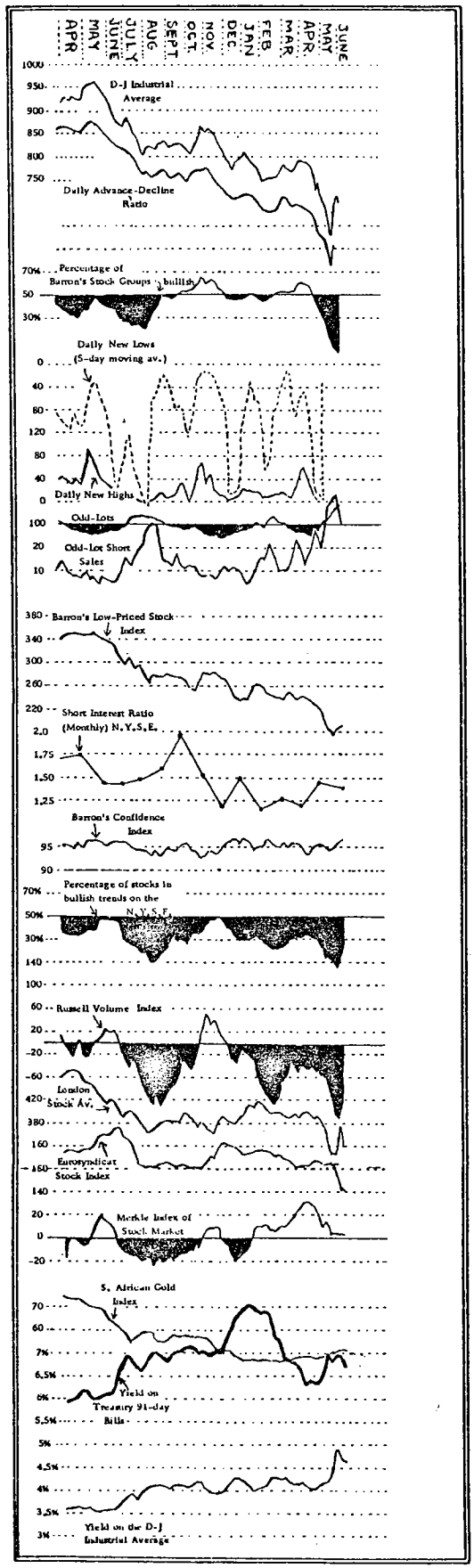
THE MARKET: Slowly, very slowly, the truth is beginning to dawn on the Government and the American people. Already, President Nixon has appeared on TV more often than any other American President within the same length of time in office. As Wall Street and the public try to piece together what the Administration is saying, a sense of frustration can be felt. The President wants to get out of Vietnam, but Cambodia is announced as a device for speeding the withdrawal. Despite dissents from close advisors, the Administration estimated that 1970 corporate profits would be $89 billion, but a House Committee now estimates profits for 1970 at $85 billion, with a $3 billion drop in the perspective corporate tax take. The President says that the economy should pick up in the third quarter and that stocks should be bought. The President was dead set against voluntary price-wage controls of any kind but he is now rumored to be considering them. Mr. Nixon promises to scale down spending, but spending continues to climb, along with the U.S. debt ceiling. And "jawboning" has become a household word across the nation, although my G.I. buddies in World War II had another name for it, as I remember.

This generation has never really seen anything "get out of hand". Even Vietnam, which has brought on such massive frustration and literally split the nation in two, cannot be called a situation which is out of control. After all, the President could call off the war tomorrow if he wanted to. The control is still in the President's hands. The same can be said to a large extent of the racial situation, poverty, pollution, all the other problems of today. These problems could be placed under control if the Government was immediately of a mind to do so. As such, the amount of frustration and fear which these problems stir up is always limited and somewhat within bounds.

But on the economic front something new is happening. For two years the Administration has attempted to control inflation, and every American knows





that the result has been almost total failure. Then, with a tightening of credit and money the stock market gave way, but inflation continued. Ask any man on the street about the stock market, however, and he is likely to tell you that if the government does this or that the stock market will be on its way up again. The widespread feeling still is that the Government (at least potentially) has everything under control.

The fantastic, "built-in" store of confidence on the part of the American people is as persistent now as it was lacking in the 1930's and early 1940's. It is the same deep-seated confidence which has, so far, kept Wall Street this side of panic.

The question is, how long will the public cling to its confidence in the omnipotence of the government? If I had to guess, I would say less than another year. For the first time in modern history, a U. S. Administration now has to deal with an unwanted force which is bigger than it is, and that is the force of the primary bear trend. The bear is intent on deflation, liquidation, squeezing the water out of the American economy and the American markets. Again and again, in rally after rally on Wall Street, the bear reaches back its giant paw and knocks the market down to new lows. And each time the stock market gets weaker and the bear gets stronger.

In my opinion, we will soon see the market groggy from these repeated blows. We will see the public losing confidence in Administration edicts and manipulations. Then the bear will rampage at will over everything, as the public finally turns stone bearish and the second phase of the bear market draws to a close and the third or final phase begins.

As for the intermediate term, in terms of breadth and the Averages, we witnessed a pseudo-crash from the April highs to the May lows (all that was lacking was huge volume). This type of crash action is always entitled to an automatic 50% recovery. From the April 2 Industrials high of 792.37, the Dow dropped 20% to a May 26 low of 631.16, a loss of 161.21 points. A 50% retracement would take the Dow back to 711.76. That figure was slightly surpassed on June 3, at which time the Dow closed at 713.96. So far so good.

If there is to be trouble (and I think there will be) it will probably come from the Transportation Index. From the March 5 peak of 178.85, the Transportation Average dropped 27% to a May 26 low of 131.53. A 50% retracement would take Transportation to 155.19. By June 3 the Transportation index peaked at 146.98, nine points below the halfway mark for a recovery of 32%. Obviously Transportation, so far, has lagged on the recovery.

We have had the April to May smash, the recovery to June 3 in both Averages, the minor correction of June 4 and 5, and on June 8 the start of the rebound to "retest" the highs. The important near-term points for the recovery are the June 3 peaks of 713.86 (Industrials) and 146.98 (Transportation). A bettering of those two peaks by both Averages will signal an extension of the rallying phase. Conversely, a failure of one or both Averages to better the June 3 peaks could signal the beginning of a new round of trouble for the market. As things now stand, if there is to be a non-confirmation on the upside it will probably come from a failure of Transportation to better the 146.98 peak of June 3.

Before I close this section, I want to comment on two important phenomena. The first is the bond market which is (as I have said over and over again) in shambles. On June 9 five schedule tax exempt bond auctions failed to draw "acceptable" bids as interest rates rose towards record highs. The bond market, in case you are not aware of it, is much bigger than the stock market and is in much more serious shape. I can't overemphasize enough that a demoralized bond market tends to rot the very foundations of the stock market.

The liquidity crisis is beginning to show in public as Lockheed, and now Penn-Central turn to the Government to guarantee their slumping credit rating (and thus keep them in business). This is an ominous trend. On June 10 the Wall Street Journal announced that the securities industry may ask the Government to guarantee a $1 billion line of credit to back their emergency fund. The moral of the story is that as liquidity reaches crisis levels, confidence ebbs and business turns to the Government for guarantees. Some of us muse that to ask the Government to guarantee your credit is to admit that your credit is precarious. And that's where we are today.

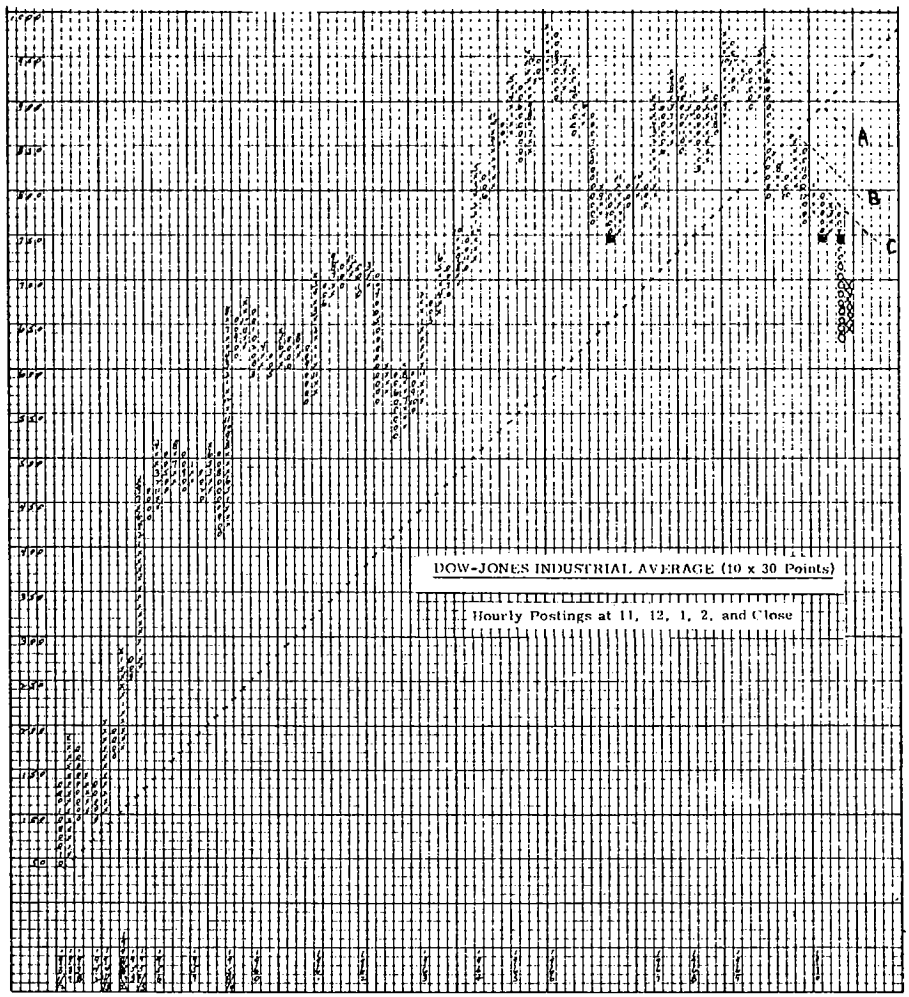
THE PUBLIC: I have explained before that this second phase in a primary bear market is working just the reverse of the second phase of the 1949-66 bull market. During the bull market's second phase, which lasted from late-1953 to 1957, the public just would not really get with the primary bull trend. Again and again, although the market was surging strongly higher, some news event would serve to panic the public. The Eisenhower heart attack, the Suez Canal crisis, the Sputnik panic, each served to "convince" the crowd that the rise was some sort of a "fluke", and that sooner or later the whole market structure would "drop down to lower levels, where it belonged".

During the second phase of the bull market (1953-57) the heavy volume continually came in on the downside, despite the fact that a great bull market was on. Examine any daily chart of that period and you will note that the spikes in volume occur during minor and major sell-offs. As a rule, during bull or bear markets, excess volume is produced by the public.

The areas of excess volume during 1953-57 were on the downside as a distrustful public took every scare as the signal to dump stock and "play it safe". It was not until the middle of the third phase of the bull market, beginning in 1963, that the public took the bit in its teeth and piled in on the upside.

Now, as the second phase of the primary bear market is on, the situation is reversed. Odd-lotters show no sign of any great fear selling. In fact, the odd-lot public bought very heavily during the rally following the May 26 low of 631.16, with many days showing more than a two-to-one ratio on the buy side. Although volume had been running under 10 million shares per day during all of 1970, volume on the current rally has pushed into the 12 to 16 million share zone. To me, this smacks of the public coming back in, convinced that everything is going to be all right, and that "current low levels" represent bargain levels indeed. Nevertheless, within a year from now I would expect the economic situation (and therefore the psychology of the public) to change drastically to the bear side. By then we should see volume coming in very definitely on the downside (with the rallies bringing in decreased volume) as this bear market probes fresh new lows.

POINT & FIGURE: I am including the P & F chart (courtesy of Chartcraft, Larchmont, N.Y.) which last appeared in Letter 460. This is a 10 points, 30 point reversal chart, which means that each box represents 10 points on the Dow, and only rallies or declines of a full 30 points or more are shown. The X's on the chart indicate rallies, the O's denote declines.



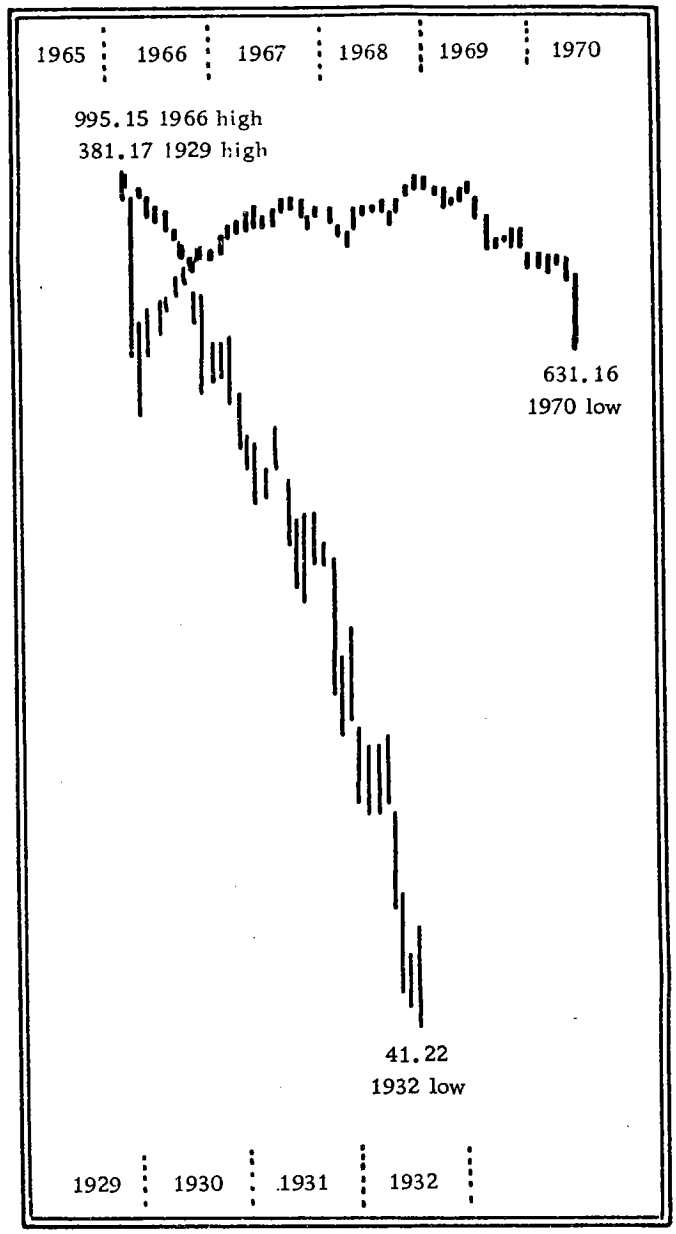
In Letter 460 I drew attention to the powerful "triple bottom" formation on the chart, and here I show the three bottoms as solid black squares. The three bottoms are all at the 750 level (the actual figures are the 744.32 low of 1966, the 744.02 low of January, 1970 and the 747.29 point of late-April 1970).

In Letter 460 I wrote that this "triple bottom" formation was extremely significant, and that ".....the shattering of this bottom constitutes a most powerful penetration". That was written with the Dow in the 730 area. Following that Letter the Dow dropped 100 points to a low of 631.16 on May 26, 1970. The drop is shown by the last row of O's which halt at the 630 box (the 630 box is filled in since the hourly low of the Dow was below 630).

I have drawn in the three important descending trendlines which has been formed since the December, 1968 peak of 985.21. These trendlines are marked A, B and C. So far, each of the downward trendlines have offered impressive resistance to any advance, and since 1968 no rally has been able to better one of these bearish or "resistance" trendlines. At present, trendline C (which is the most recent trendline) would offer resistance to any rally at the 750-760 level). I do not know how far the current rally is capable of carrying, but I would expect really important resistance in the area of the C trendline or the 750-760 area (assuming the rally can carry that far).

COMPARISONS: There has been much comment lately regarding the current bear market and the 1929 to 1932 affair. I have been drawing my own comparisons, and as usual I do not agree with most of the other commentators.

In terms of breadth (i.e., advance-declines) there is little doubt that the current bear market is beginning to look like 1929-32. If you refer to Letter 452 containing the monthly chart of the Dow and the A-D ratio going back to 1919, you will immediately see that the collapse in the mass of issues on the N.Y.S.E. in terms of the A-D ratio is already one of the worst such downmoves in history. But in terms of the price of the D-J Industrial Average, the decline, so far, is far, far from looking like 1929-32.



I have included a chart showing the monthly high-lows of the Dow for two periods, 1929 to 1932 and 1966 to date. The first bar on the chart for the 1929-32 movement starts in September, 1929, the month of the high close of 381.17. The first bar for the 1966 to date movement is February, 1966, the month which contained the high close of 995.15 for the Dow. The chart is drawn to ratio (or percentage) scale, which means that all movements are shown in percentages. In this way the two periods can be compared correctly. The time periods of both can be compared accurately, since the scales are the same. For instance, the year 1967 occupies exactly the same space on the chart as the year 1930.

In time, it is immediately apparent that the current bear market has surpassed 1929-32. But then why shouldn't it. The 1921-29 bull market lasted eight years, while the 1949 to 1966 bull market lasted seventeen years or more than twice as long. Therefore, it is logical that the bear market following the 1966 top should last longer than the bear market following the 1929 top. Furthermore, with constant government manipulation and interference, all movements today tend to take longer than was the case forty years ago.

Obviously, the glaring difference in the 1929-32 bear market and today's bear market is (at this time) amplitude. At the 1932 bottom the Dow had erased 89% of its value. So far in the current bear market the Dow has lost 36% of its value. If the Dow was to drop on this chart to the low level of 1932, it would have to sink to 100.

The obvious question now is, "How far will this bear market go before it is over?" My answer is singularly unsatisfactory, for I simply have no idea. I have said before that the majority of bear markets correct at least half the gains of the preceding bull market. If the Dow wipes out half the gains of 1949-1966 (161.60 to 995.15), it would sink to 578. During any primary bear market the odds always favor a decline of better than 50%, and the greater and more speculative the preceding bull market, the greater the odds of a major bear market which wipes out more than 50% of the preceding gains.

It makes a lot more sense to me to attempt to identify a bear market bottom when it arrives than to guess as to what level it "should" arrive. I noted in the last Letter that I do not think the second phase of the bear market is over. There is still too much bullishness around, the market never went into a panic, too many people are talking about "the worst being over". However, even assuming that the second phase did end on May 26 at 631.16, we still have the third phase of the bear market to go through.

Therefore, my thought is that we should put all preconceived notions aside. We should concentrate our attention on where we are in terms of the total potential bear market. My thinking, charts and calculations indicate that we are still a long way from the bear market bottom. Final bottom indications could conceivably arrive at 580 or 300, I have no way of knowing. Until then the best policy is patience and a very open mind.

Europeans Angry at U.S. On Drop in Their Markets

Investors Abroad Have Losses in Stock and Bond Holdings and in Mutual Funds Sold by Americans

By CLYDE H. FARNSWORTH
Special to The New York Times

COPENHAGEN, May 31—One European securities man to the other:

"Why can't some authority decide how long the working day should be?"

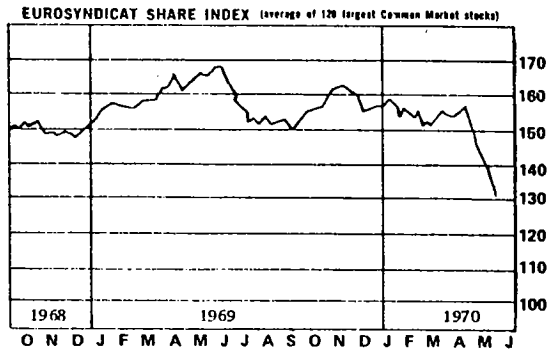
"Do you personally think it's too long or too short?"

"Too short."

"Listen, that's the reason we're still alive to make markets."

Once again demonstrating that when the United States sneezes the rest of the world catches cold, the European securities industry has fallen into the depths of recession. Trading institutions have taken large losses, and difficulties have been aggravated in the already clogged capital market.

No European stock market has been strong enough to withstand the pressures from New York, a development of political as well as economic significance.

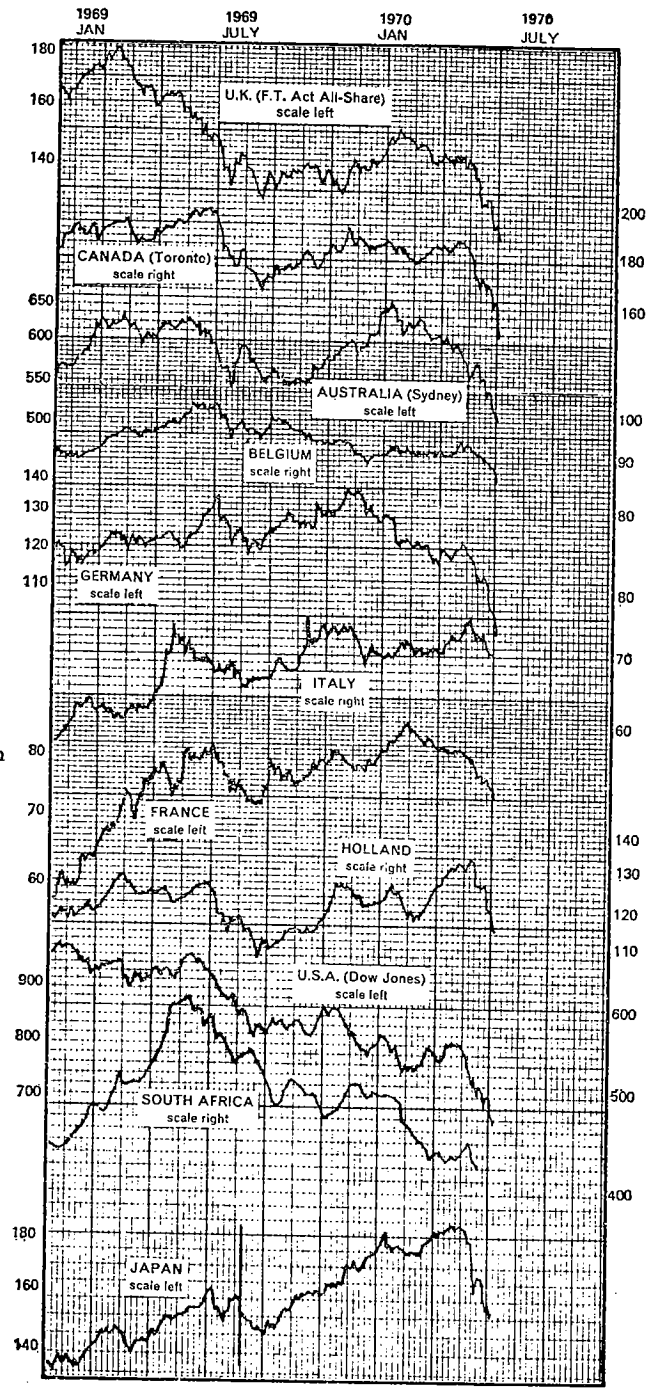


INTERNATIONAL MARKETS: I have mentioned before that true primary movements tend to be international in scope. For instance, a primary bear market will affect sales, shipping, imports and exports, wages, prices, the entire economic gamut. This type of action is bound to have a "spreading out" effect, which will in due time be felt throughout the world.

Country	% change fr Jan 1, 70 to May 29, 70	% change since high:	Date of high
Sweden	—23.3	—35.2	May 69
Australia	—21.3	—21.8	Jan. 70
Germany	—20.3	—24.3::	Nov. 69
U. S.	—19.0	—31.9	Nov. 68
Britain	—13.9	—34.6	Jan. 69
Canada	—17.3	—22.4	May 69
Switzerlnd	—16.2	—27.7	May 69
Netherl'ds	—12.9	—26.3	May 69
Japan	—12.6	—15.0	Mch 70
Denmark	—12.3	—31.5	July 66
France	— 9.4	—37.2::	Mch 62
Spain	— 8.4	—15.7	Mch 70
Italy	— 6.2	—43.4	Aug. 60
Belgium	— 4.9	—17.6	Jan. 65
Norway	— 0.6	— 9.4	Apl. 70
Austria	— 0.3	—34.7	Jan. 62
E.E.C.	—13.1	—16.4	May 69
Europe	—15.6	—21.7	Jan. 69
World	—17.9	—26.9	Nov. 68

This chart at lower right (courtesy International Investor, 354 Kennington Rd., London, S.E. 11, England) shows what has occurred so far on the international front. Note that giant downward zig-zags (which we can term "bear signals") have appeared in the stock Averages of all nations except Italy, France, Holland and Japan. As the bear market progresses and its persistence becomes apparent, I would expect the stock Averages of those four countries to trace the same bearish profile seen in the rest of the markets of the Free World.

This chart is drawn to ratio scale, which means that all movements are shown in percentages. This means that each of the stock averages can be compared accurately with any other simply by measuring the distances with a pair of dividers. Interestingly, the two nations which have suffered the worst market drops from their 1969 peaks are the U.S. and England (the latter has even surpassed the U.S.). Since these are the two nations which have been most willing to espouse the philosophy of "inflate now, pay later," it is obvious that they are in the "paying stage" now.



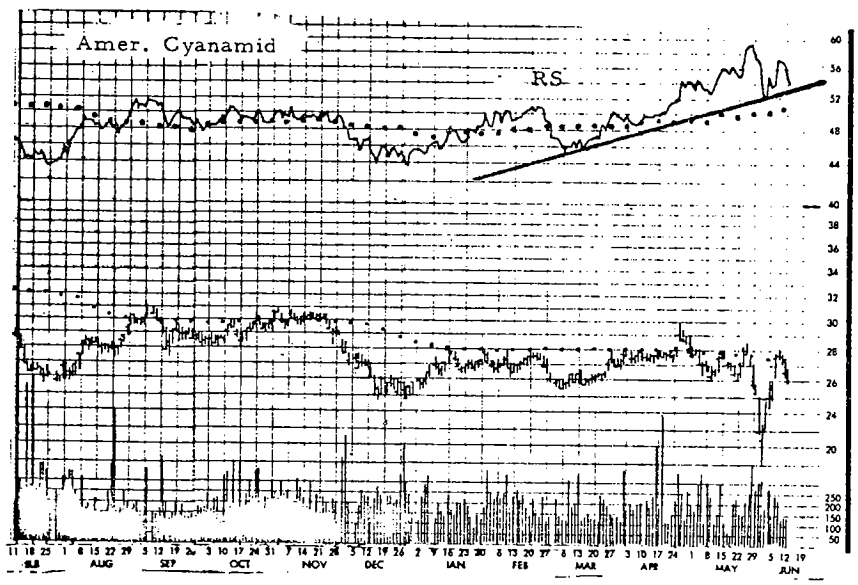
From another standpoint, Capital International S.A. has put out a tabulation of foreign market indices (see page 5) showing percentage changes in 1970, percentage of each index from its bull peak and the date of each bull market peak. As you can see, the primary bear trend has not left a plus in the lot.

I also include, on page 5, a chart (courtesy of Indicator Chart Service, Palisades Park, N.J.) showing the Eurosyndicat Index of the 120 largest common market corporations. Since mid-1969, the index has dropped over 20%.

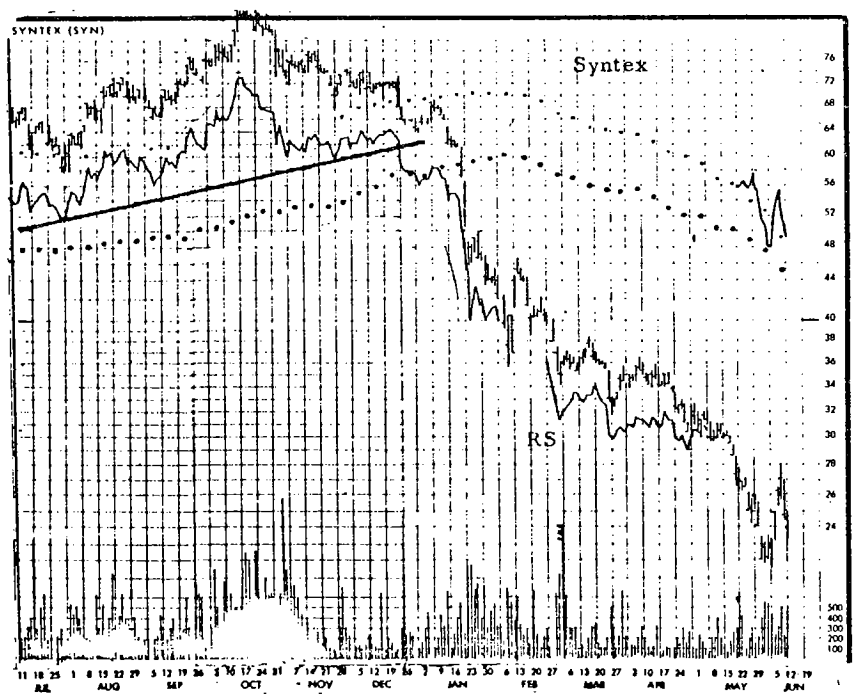
In view of all this, I thought this June 1 headline (see page 5) in the New York Times financial section was almost humorous. After all, when you're in trouble it's comforting to blame somebody else, and the Europeans are no exceptions. And as you can see, we're taking full blame for the decline in overseas markets.

STOCKS: I am including a few stocks for illustration purposes, charts courtesy of my friends at Traders Research, 101 Cherry St., Alton, Ill. 62002. Here we see price, and the fine dotted line which is a 30-week average of price. Then we see the solid black line which is the relative strength of each stock compared with the market, and the heavy dotted line which is the 30-week moving average of relative strength.

The stock of syntex was showing rising relative strength (RS) through to December, 1969. I have drawn a trendline connecting the rising bottoms in RS. In December, with the stock at 68, the RS trendline was broken. When that occurs in a primary bear market, the sell signal (assuming you hold any stocks in a bear market) should never be ignored. Those who ignored the signal saw Syntex drop to 22 within five months. Holders of Syntex would have called the action a disaster. Students of RS would refer to it as a testiment to technical analysis.



American Cyanamid is a more sanguine proposition. Here we see a distinct rise in RS since December, 1969. Note that rising RS in a bear market does not necessarily imply that your stock is increasing in price, it merely means that your selection is acting better than the market. In late-May, 1970, the near-crash drove ACY down from 28 th a low of 18. But superior RS will show itself, and this month the stock bounced back into the 26-28 area. I have drawn in the most recent ascending trendline in RS for Cyanamid. The RS line has become a little shaky of late, and as a trader I would use a breaking of the trendline as a sell signal.



These studies are in no way recommendations to trade stocks in a primary bear market. They are merely intended to educate readers to the use of RS.

LATE NOTES & OPINIONS: Watch the 672 Dow level. Failing to hold 672, the Dow will probably "test" the 1970 low, and I doubt that such a test would be successful. June 11...Homestake opened up at a new high for the year, as the dollar weakens in relation to other leading currencies. I believe the Government stepped in on the Penn-Central mess to avert a possible market panic.